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## FINANCIAL MARKETS UPDATE

June 30, 2008

This June is on pace to be the worst June since 1930. The rally that began on March 17<sup>th</sup> with the collapse and buyout of Bear Stearns has rolled over. The financial services sector began a 20%+ rally on the theory that the market's worst fears about its solvency were priced in and therefore we had nowhere to go but up. Obviously, that theory turned out not to be true. Regional banks have led a 25% slide since early May on the belief that they are going to have to write down a tremendous amount of real estate and personal loans. Technology has also slumped as hopes for increased business spending in the second half of the year are being written off. The only part of the market that is strong right now is energy (no surprise there), but while we have exposure there we really don't want to be chasing a sector that is trading near all-time highs.

Recently there was a report in the local newspaper (Minneapolis Star Tribune) which pointed out that the economy had not even had one negative quarter during this downturn and asked why everyone felt so bad. We believe this is an easy question to answer. Gross Domestic Product (GDP) is an attempt to measure a country's economic progress. It measures the period-to-period increase or decrease in production and then discounts it by the percentage of that change that resulted from increasing prices (inflation). If the calculations understate inflation, GDP will be overstated. For the majority of Americans, Gross *Personal* Product is negative. That is to say, the amount they are earning relative to what they earned last year is up, but the cost of buying the same things they bought last year has risen at a faster clip. That is why consumer sentiment has fallen to levels not seen since the 1970s. We feel bad because things *are* bad.

That said it is unlikely that the proximate cause of the misery for most of us (oil) will keep rising at the pace it has been. If it did, we would be looking at well over \$250 by this time next year. Before we'd get to that point there would be major changes in oil usage in the economy, and the government would probably tap into the Strategic Petroleum Reserve. In fact, a slide in oil prices is probably more likely given increased production and slowing demand growth. That could spark a rebound in consumer confidence and stock prices. It is important not to expect the future to be merely a continuation of the recent past. You have to factor in the dynamism of markets. Price extremes, whether high or low, and whether you are talking commodities or stocks or collectibles, tend to correct themselves.

This quarter has been tough, especially on what are normally the safer parts of the market. Bonds are down nearly 2% and the Dow Jones Industrial Average is off 7%. On the other hand, the NASDAQ is actually ahead 1.6% and cash is up 0.5%. That's the bad news, now the good news; CSFC Balanced accounts on average are down less than -1% for the quarter and down only -2.5% Y.T.D. Our overweighting in cash continues to be effective as has our mutual fund selections which have done very well especially in our more aggressive portfolios. Look forward to our full commentary is about two weeks.

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